

**RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS**

**Financial Statements for the
Year Ended November 30, 2011
and Independent Auditors' Report**

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Members
Rural Water District No. 2
Miami County, Kansas

We have audited the accompanying statement of net assets of Rural Water District No. 2, Miami County, Kansas as of November 30, 2011, and the related statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rural Water District No. 2, Miami County, Kansas as of November 30, 2011, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States of America.

The management discussion and analysis on pages 2 through 4 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Acord Cox & Co.

December 20, 2011

Rural Water District No. 2
Miami County, Kansas

Management's Discussion and Analysis

This section of the Rural Water District No. 2, Miami County, Kansas annual financial report presents an analysis of the District's financial performance during the year ended November 30, 2011. This information is prepared and presented in conjunction with the annual audited financial reports prepared by the District's independent auditing firm.

Rural Water District No. 2 Financial Overview for 2011

- The District's total assets increased by \$520,523 from \$20,935,107 in 2010 to \$21,455,630 in 2011.
- The District's revenues from water sales increased by \$226,683 from \$2,410,358 in 2010 to \$2,637,041 in 2011.
- The District's costs and operating expenses decreased by \$146,163 from \$2,416,665 in 2010 to \$2,270,502 in 2011.
- During 2011 the District made capital expense investments of \$156,202.

Overview of the Financial Statements

This report will include Management's Discussion and Analysis, Financial Statements for the year ended November 30, 2011, along with the Independent Auditors' Report. The Independent Auditors' Report will include notes and supporting details for information presented in Management's Discussion and Analysis.

Required Financial Statements

The Financial Statements of the District report information by using accrual accounting practices. The Financial Statements conform to accounting principles that are generally accepted in the United States of America. The Statement of Net Assets include information on the District's assets and liabilities and provide information about the type and amounts of investments (assets) secured and the obligations to the District's creditors (liabilities). The Statement of Activities and Changes in Net Assets exhibit the District's revenues and expenses for the year ended November 30, 2011. The Statement of Cash Flows present information on the District's cash receipts, cash payments and changes in cash flow resulting from operations, investments and financing activities.

Financial Analysis of the District

The Statement of Net Assets and the Statement of Activities and Changes in Net Assets present information on the District's financial condition. The District's net assets are indicated by the difference between its assets and liabilities. An improvement in the District's financial condition is reflected in its increase of net assets.

Net Assets

A summary of the District's Statements of Net Assets is presented below.

Table 1
Condensed Statements of Net Assets

Current Assets	3,592,985
Noncurrent Assets	1,740,954
Capital Assets, net	16,121,691
Total Assets	21,455,630
Current Liabilities	181,578
Total Liabilities	181,578
Net assets invested in capital assets, net of related debt	16,121,692
Restricted	-
Unrestricted	5,152,360
Total Net Assets	21,274,052

Total assets increased by \$520,523 from \$20,935,107 in 2010 to \$21,455,630 in 2011. This is a result of increases in cash accounts. Capital assets are a net result of all fixed assets, including 2011 additions, less accumulated depreciation.

Total liabilities decreased by \$40,198 from \$221,776 in 2010 to \$181,578 in 2011. Fewer line extension deposits and advanced benefit unit payments were received in the current year.

Total net assets increased by \$560,721 from \$20,713,331 in 2010 to \$21,274,052 in 2011.

Table 2
Condensed Statement of Activities and Changes in Net Assets

Operating Revenues	2,637,041
Non-operating Revenues	46,782
Total Revenues	2,683,823
Depreciation Expense	685,407
Other Operating Expense	1,585,095
Total Expenses	2,270,502
Income Before Capital Contributions	413,321
Capital Contributions	147,400
Changes in Net Assets	560,721
Beginning Net Assets	20,713,331
Total Net Assets	21,274,052

The Statement of Activities and Changes in Net Assets represent revenue and expense items that affect the change in net assets. As the information presented in Table 2 shows, income before capital contributions was \$413,321 with capital contributions of \$147,400, which resulted in a net increase in net assets of \$560,721 for the year ended November 30, 2011.

The District's total operating revenues increased by \$226,683 from \$2,410,358 in 2010 to \$2,637,041 in 2011. Total operating expenses decreased by \$146,163 from \$2,416,665 in 2010 to \$2,270,502 in 2011. The major contributors to the decrease in expenses were related to plant expense and professional services.

Additional Financial Information

This financial report is designed to provide the District's patrons, investors and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact Rural Water District No. 2, Miami County, KS Business Manager at P. O. Box 186, Hillsdale, KS 66036.

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENT OF NET ASSETS
NOVEMBER 30, 2011

ASSETS

CURRENT ASSETS

Cash	\$ 2,527,988
Certificates of deposit	734,922
Accounts receivable	164,109
Accounts receivable - wholesale	47,955
Interest receivable	1,982
Prepaid expenses	11,983
Inventory	<u>104,046</u>
Total current assets	<u>3,592,985</u>

NONCURRENT ASSETS

Funds designated for capital improvement	<u>1,740,954</u>
Total noncurrent assets	<u>1,740,954</u>

CAPITAL ASSETS

Nondepreciable capital assets	<u>809,589</u>
Depreciable capital assets	26,193,791
Less accumulated depreciation	<u>(10,881,689)</u>
Depreciable capital assets, net	<u>15,312,102</u>
Total capital assets, net	<u>16,121,691</u>
Total assets	<u>21,455,630</u>

LIABILITIES

CURRENT LIABILITIES

Accounts payable	80,715
Other accrued liabilities	61,843
Line extension deposit	27,020
Advance benefit unit payments	<u>12,000</u>
Total current liabilities	<u>181,578</u>

NET ASSETS

Invested in capital assets, net of related debt	16,121,692
Restricted	-
Unrestricted	<u>5,152,360</u>
Total net assets	<u>\$ 21,274,052</u>

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED NOVEMBER 30, 2011

WATER SALES	\$ 2,637,041
COSTS AND OPERATING EXPENSES:	
Personnel costs	589,015
Depreciation and amortization	685,407
Chemical expense	168,349
Plant expense	128,800
Line maintenance	68,455
Water purchased	83,895
Water samples	1,344
Sales and use tax	3,510
Utilities	231,042
Contract meter reading	62,079
Professional services	45,658
Vehicle upkeep	68,027
Office supplies	56,783
Insurance	28,725
Tower maintenance	3,709
Dues	10,302
Miscellaneous	17,088
Water plan tax	9,305
Bad debts	667
Clean drinking water fee	8,342
	<u>2,270,502</u>
INCOME FROM OPERATIONS	<u>366,539</u>
NON-OPERATING REVENUES:	
Interest income	<u>46,782</u>
INCOME BEFORE CONTRIBUTIONS	413,321
CONTRIBUTIONS - BENEFIT UNITS AND AID-IN CONSTRUCTION	<u>147,400</u>
INCREASE IN NET ASSETS	560,721
NET ASSETS, BEGINNING OF YEAR	<u>20,713,331</u>
NET ASSETS, END OF YEAR	<u>\$ 21,274,052</u>

RURAL WATER DISTRICT NO. 2
MIAMI COUNTY, KANSAS

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED NOVEMBER 30, 2011

OPERATING ACTIVITIES:

Cash receipts from customers	\$ 2,579,195
Cash payments to suppliers for goods and services	<u>(1,565,847)</u>
Net cash provided by operating activities	<u>1,013,348</u>

CAPITAL AND RELATED FINANCING ACTIVITIES:

Additions to capital assets	(156,202)
Contributions - Benefit units and aid-in construction	<u>147,400</u>
Net cash used in capital and related financing activities	<u>(8,802)</u>

INVESTING ACTIVITIES:

Change in certificates of deposit	459,751
Interest received	<u>46,782</u>
Net cash provided by investing activities	<u>506,533</u>

NET CHANGE IN CASH AND CASH EQUIVALENTS 1,511,079

CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR 1,016,909

CASH AND CASH EQUIVALENTS, END OF YEAR \$ 2,527,988

Reconciliation of Operating Income to Net Cash Provided by Operating Activities:

Operating income	\$ 366,539
Adjustments to reconcile operating income	
to net cash provided by operating activities:	
Depreciation and amortization	685,407
Changes in:	
Accounts receivable	(20,706)
Inventories	(9,689)
Prepaid expenses	(1,225)
Interest receivable	1,829
Other receivable	31,391
Accounts payable and accrued liabilities	(3,058)
Line extension deposits	(14,640)
Advanced benefit unit payments	<u>(22,500)</u>
Net cash provided by operating activities	\$ <u><u>1,013,348</u></u>

RURAL WATER DISTRICT NO. 2

MIAMI COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED NOVEMBER 30, 2011

1. DESCRIPTION OF ENTITY

- a. Organization and Description of Operations – The Rural Water District (the “District”) was established as a tax exempt organization under the laws of the State of Kansas and is governed by an independent Board of Directors. Principal functions of the District include the acquisition, treatment and distribution of water to owners and occupants of land located within the district. There were 3,600 customers at November 30, 2011.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- a. Basis of Presentation and Accounting – The District’s financial statements are presented on the full accrual basis of accounting and conform to accounting principles generally accepted in the United States of America. The District has elected under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting*, to apply applicable GASB pronouncements, including GASB Statement No. 34, as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board, or any Accounting Research Bulletins, unless these pronouncements conflict with or contradict GASB pronouncements.

The accounts of the District are organized on the basis of a proprietary fund type, specifically an enterprise fund. The activities of this fund are accounted for with a separate set of self-balancing accounts that comprise the District’s assets, liabilities, net assets, revenues and expenses.

The accounting and financial reporting treatment applied to the District is determined by its measurement focus. The transactions of the District are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operations are included in the statement of net assets. Net assets (i.e. total assets net of total liabilities) are segregated into invested capital assets, net of related debt; restricted for debt service; and unrestricted components.

Management of the District has made certain estimates and assumptions relating to the reporting of assets and liabilities and revenues and expenses to prepare these financial statements in conformity with generally accepted accounting principles. Actual results may differ from those estimates.

- b. Cash Equivalents – For purposes of the statements of cash flows the District considers all highly liquid debt investments having original maturities of three months or less to be cash equivalents.
- c. Inventories – Inventories consist primarily of meters, line maintenance material and chemicals. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.
- d. Loan Issue Costs – Costs related to obtaining loans have been capitalized and are being amortized on a straight-line basis over the term of the corresponding loan.

- e. Capital Assets – The cost of additions to the District’s plant, distribution system and other assets with an estimated useful life in excess of two years are capitalized. Cost includes materials, outside services and if applicable, interest on borrowed funds to finance construction. The District did not capitalize interest during the fiscal year 2011. The cost and accumulated depreciation of property sold or retired is deducted from capital assets, and any profit or loss resulting from the disposal is credited or charged in the nonoperating section of the statement of revenues, expenses and changes in net assets.

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

- f. Income Taxes – The District is a quasi-governmental unit, not subject to federal or state income taxes.
- g. Capital Contributions – Transmission and distribution system assets contributed to the District are capitalized at the members’ costs, which approximate fair value, and recorded as capital contributions when received.
- h. Net Assets – Net assets comprise the various net earnings from operating income, nonoperating revenues and expenses, and capital contributions. Net assets are classified in the following three components:

Invested in Capital Assets, Net of Related Debt – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

Restricted – This component of net assets consists of constraints imposed by creditors (such as through debt covenants), grantors, contributors or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

3. CAPITAL ASSETS

Changes in capital assets were as follows:

	2010	Additions	Transfers/ Disposals	2011
Nondepreciable capital assets:				
Land and easements	82,511	172	-	82,683
Construction in progress	1,141,878	87,744	(502,716)	726,906
	<u>1,224,389</u>	<u>87,916</u>	<u>(502,716)</u>	<u>809,589</u>
Depreciable capital assets:				
Plant and intake	8,250,915	-	-	8,250,915
Towers and standpipe	1,047,195	-	-	1,047,195
Transmission and distribution	15,768,054	538,106	-	16,306,160
Pumps and motors	152,559	2,873	-	155,432
Office furniture and equipment	235,801	6,123	-	241,924
Vehicles	141,318	20,786	(13,813)	148,291
Equipment	40,760	3,114	-	43,874
	<u>25,636,602</u>	<u>571,002</u>	<u>(13,813)</u>	<u>26,193,791</u>
Less accumulated depreciation	<u>(10,210,095)</u>	<u>(685,407)</u>	<u>13,813</u>	<u>(10,881,689)</u>
Depreciable capital assets, net	<u>15,426,507</u>	<u>(114,405)</u>	<u>-</u>	<u>15,312,102</u>
Total capital assets, net	<u>16,650,896</u>	<u>(26,489)</u>	<u>-</u>	<u>16,121,691</u>

4. CASH AND INVESTMENTS

Deposits – At November 30, 2011, the District’s deposits were covered by federal depository insurance or by collateral held by the District’s agent in the District’s name.

Investments – State statutes also authorize municipalities to invest general operating monies in direct obligations of the United States government or its agencies or in repurchase agreements if local financial institutions are not able to pay the average Treasury bill rate. All investments must be insured, registered or held by the municipality or its agent in the municipality’s name.

The District’s investments are categorized as either (1) insured, registered or securities held by the District or its agent in the District’s name, (2) uninsured and unregistered for which the securities are held by the broker’s or dealer’s trust department or agent in the District’s name (3) uninsured and unregistered for which the securities are held by the broker or dealer, or by its trust department or agent but not in the District’s name. The District’s investments at November 30, 2011 are summarized below:

	<u>Carrying Value</u>	<u>Market Value</u>	<u>Category</u>
Investments:			
Certificates of Deposit	\$ 734,922	\$ 734,922	1
Funds Designated for Capital Improvement:			
Certificates of Deposit	\$ 1,740,954	\$ 1,740,954	1

5. LONG-TERM WATER SUPPLY CONTRACTS AND AGREEMENTS

In connection with the original construction of the water treatment plant, a long-term contract was entered into with RWD #7 of Johnson County to provide water to that district. In addition to paying monthly charges based upon actual water usage, RWD #7 also agreed to pay an amount equal to 8.63% of the District's Water System Revenue Bonds, Series 1993. In connection with the plant expansion and the retirement of the 1993 bonds, the District amended and restated the water supply contract with RWD #7. Under the amended contract RWD #7 agreed to pay an amount equal to 10.94% of the Series 1998 Bonds.

The District also received \$333,143 in 1999 from RWD #7 for their portion of the costs associated with establishing the 1998 Bond issue which was amortized to non-operating income over a ten-year period.

In March of 2006, the District amended the wholesale water contract with RWD #7 and contributed \$337,037 for capital costs related to the water treatment plant.

In January of 2000, the District entered into a 20-year water supply contract with Rural Water District No. 1 (Miami No. 1), Miami County, Kansas. Under the agreement, the District is required to sell water to Miami No. 1 at rates based on a formula defined in the agreement.

In July of 2000, the District entered into a 30-year water supply contract with Rural Water District No. 1 (Franklin No. 1), Franklin County, Kansas. Under the agreement, the District is required to sell water to Franklin No. 1 at rates based on a formula defined in the agreement.

In July of 2003, the District entered into a water distribution contract with the City of Spring Hill, Kansas (Spring Hill) and RWD #7. Simultaneous with the water distribution contract, the District entered into a 20-year water supply contract with Spring Hill. Under the agreement, the District is required to sell water (not to exceed one million gallons per day) to Spring Hill at rates based on a formula defined in the agreement.

In February of 2006, the District entered into a 20-year water supply contract with the City of Edgerton, Kansas (Edgerton). Under the agreement, the District is required to sell water (not to exceed 250,000 gallons per day) to Edgerton at rates based on a formula defined in the agreement. Either party may, without cause, terminate the contract as of the 10-year anniversary of the contract upon 24 months prior written notice to the other party.

6. PENSION PLAN

Substantially all of the District's employees participate in the Kansas Public Employees Retirement System ("System"), a multiple employer public employee retirement system. Total payroll for employees covered by the System was \$426,422 in 2011.

Employees are vested upon hire and are required by state statute to contribute 4% of their salary (6% for employees hired after July 1, 2009) to the System. The District is required by statute to contribute the remaining amounts using the full funding method, which funds current costs each year and past service

liability over a 40-year period. The District's monthly contribution rates are defined by the State and ranged from 6.14% to 6.74% in 2011. The contribution requirement for the year ended November 30, 2011 was \$52,665, which consisted of \$20,924 from employees and \$31,741 from the District.

The District has a 457 deferred compensation plan. Under the Plan the District matches employee contributions at rates from 2.50% to 4.50% depending upon years of service. For the year ended November 30, 2011 the District's contribution to the Plan totaled \$14,912.

7. ADVANCE BENEFIT UNIT PAYMENTS

Potential customers desiring water service within the District are required to submit an application for a benefit unit along with a deposit for the cost of a benefit unit. Such payments, refundable only if service cannot be provided, totaled \$12,000 at November 30, 2011.

8. COMPLIANCE WITH KANSAS STATUTES

References made herein to the statutes are not intended as interpretations of law, but are offered for consideration of the Director of Accounts and Reports and interpretation by the County Attorney and legal representatives of the Water District. There were no apparent statutory violations during the year ended November 30, 2011.

9. SUBSEQUENT EVENTS

Management has evaluated subsequent events through December 20, 2011, the date which the financial statements were available for issue and determined there are no subsequent events required to be disclosed.

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